

## Budget Message

June 30, 1999

To the Honorable Mayor and City Council:

Transmitted herein is the City's FY 1999-2001 biennial operating budget, the first ever two-year budget for the City of Tempe. While this is a dramatic change in how Tempe allocates resources, biennial budgeting will encourage a longer term view of financial planning and shift the emphasis from the process itself to a more careful examination of our resource allocation choices. As an additional benefit, moving to a budget process that occurs every other year rather than each year will allow City departments greater time to focus on service delivery and program improvements.

### **Budget in Brief**

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The adopted operating budget for FY 1999-00 (Year 1) totals \$197.9 million, a \$7.5 million or 3.9% increase over FY 1998-99. The operating budget increases in FY 2000-01 (Year 2) by \$10.9 million or 5.5% to \$208.8 million.

Several factors contribute to the changes in the budget from a year ago, as described below:

- **Supplemental Funding.** The two-year budget includes an additional \$9.0 million across all funds for program expansions and new

initiatives to address the City's strategic goals and priorities. Of this new funding, \$2.6 million will address needs in our public safety and criminal justice program. An additional \$1.5 million addresses needs in water/wastewater operations, and sanitation and facility maintenance, while a \$1.2 million increase for Community Services reflects the City's continued commitment to youth and social services programs.

- **Police Staffing.** As a result of a comprehensive study of police staffing levels, \$2.4 million was added to the Police department to increase the number of officers on patrol and to address workload concerns in key police support functions.
- **Inflation and related costs.** Inflation, projected at 2-2.5%, coupled with projected population growth of 1.1% annually over the biennium, contribute to budget increases.

### **Budget Highlights**

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#### **Total Financial Program**

The following tables depict the adopted biennial

| Biennial Budget<br>Total Financial Program |                      |                      |
|--|----------------------|----------------------|
|  | FY 1999-00           | FY 2000-01           |
| <b>Operating Budget</b>                    | <b>\$197,926,204</b> | <b>\$208,817,681</b> |
| Percent Change                             | 3.9%                 | 5.5%                 |
| <b>Capital Improvements</b>                | <b>\$85,587,326</b>  | <b>\$61,256,862</b>  |
| Percent Change                             | -2.4%                | -28.4%               |
| <b>Total Financial Program</b>             | <b>\$283,513,530</b> | <b>\$270,074,543</b> |
| Percent Change                             | 1.9%                 | -4.7%                |

| Biennial Operating Budget<br>by Fund |                      |                      |
|--------------------------------------|----------------------|----------------------|
|                                      | FY 1999-00           | FY 2000-01           |
| General Fund                         | \$105,056,812        | \$112,454,796        |
| Special Revenue Funds                |                      |                      |
| Transportation                       | 12,659,931           | 13,104,279           |
| Transit                              | 15,781,042           | 19,096,197           |
| Rio Salado                           | 1,452,645            | 1,475,225            |
| CDBG/Section 8                       | 7,559,997            | 7,559,997            |
| Debt Service                         | 6,021,662            | 5,208,799            |
| Enterprise Funds                     |                      |                      |
| Water/Wastewater                     | 36,644,264           | 37,401,040           |
| Sanitation                           | 10,600,519           | 10,380,122           |
| Golf                                 | 2,149,332            | 2,137,226            |
| <b>Total Operating Budget</b>        | <b>\$197,926,204</b> | <b>\$208,817,681</b> |

total financial program (operating and capital improvements budgets) and the operating budget detailed by fund. The size of our total financial program lowers over the biennium as major capital projects such as the Rio Salado Town Lake and transit bus purchases near completion.

### Personnel

Total proposed full-time positions equal 1,623 for FY 1999-00 and 1,657 for FY 2000-01. This represents a net increase of 33 full time supplemental positions in Year 1 and 20 in Year 2, and 13 full time positions associated with CIP operating impacts in Year 1 and 14 in Year 2. An additional 20 positions related to our Police staffing review (the "ILJ Study") were added to the Police Department in 1999-00.

### Pay-As-You-Go

Total "pay-as-you-go" financing within the Capital Improvements Program includes \$44.6 (FY 1999-00) and \$30.1 (FY 2000-01) million from operating revenues, reflecting a \$16.2 million increase and \$14.5 million decrease over each of the preceding year's "pay-as-you-go" financing.

### Capital Improvements

The Total Capital Improvements Program is \$85.6 (FY 1999-00) and \$61.3 (FY 2000-01) million, down \$2.1 and \$24.3 million from each of the previous year's programs. Highlights of the biennial capital program include:

#### FY 1999-00

- Funding for additional bus purchases (\$16,640,000);
- Funding for the Rio Salado Project (\$13,177,308) including:
  - final funding for the Rio Salado Parkway from Farmer to College (\$3.0 million);
  - funding for improvements to the Rio Salado North Bank from College to the west dam (\$2.0 million);
  - continued funding for Tempe Beach Park Improvements (\$2.0 million); and
  - continued funding for the Lagoon/Marina Phase I (\$1.5 million);
- Continued funding for the 91<sup>st</sup> Avenue Wastewater Treatment Plant (\$9.6 million) including continued funding (\$5.0 million) for additional treatment capacity and \$4.6 million for environmental compliance modifications and improved efficiencies;
- Continued funding for expansion of the South Tempe Water Plant (\$6.0 million);
- Continued funding for local and major street renovations and reconstruction (\$4,491,072); and
- Continued funding for bus stop improvements (\$2,231,000).



## FY 2000-01

- Continued funding for the 91<sup>st</sup> Avenue Wastewater Treatment Plant (\$12.0 million) including continued funding (\$8.0 million) for additional treatment capacity and \$4.0 million for environmental compliance modifications and improved efficiencies;
- Continued funding to determine the feasibility of a rail transit corridor (\$7.5 million);
- Continued funding for expansion of the South Tempe Water Plant (\$3.0 million);
- Continued funding for local and major street renovations and reconstruction (\$2,659,368);
- Continued funding for bus stop improvements (\$2,231,000);
- Continued funding for the Rio Salado Parkway from McClintock to Price (\$2,073,000); and
- Continued funding for the construction of a downtown fire station (\$1,750,489).

As the graphs below depict, the operating budget represents 70% of the FY 1999-00 total financial

program, increasing to 77% in FY 2000-01 as the size of our CIP budget falls. Department budgets make up just over 80% of the citywide operating budget, with debt service comprising the second largest share.

## Revenue Considerations

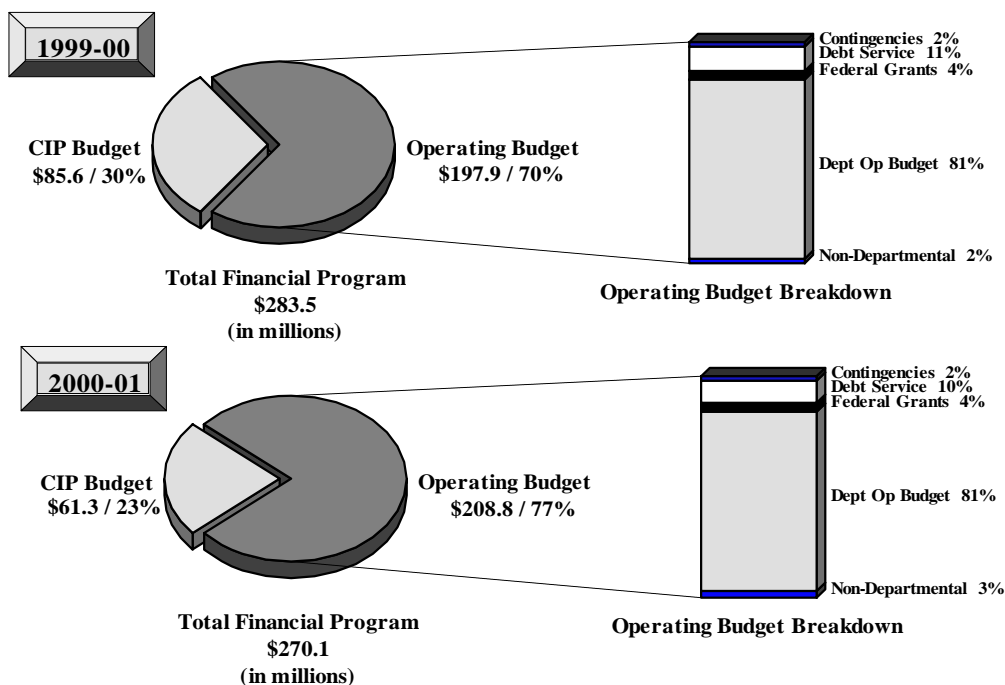
The City will modify revenue as needed in several areas for FY 1999-00.

### Water/Wastewater

**For FY 1999-00, there will not be a water rate increase.** Sewer rate increases will continue the phased-in approach, adjusted to attain full cost recovery as customer charges are based upon water consumption and strength of discharge into the sewer system.

### Sanitation Fees

**There is no sanitation fee adjustment proposed for FY 1999-00.** Upon finalizing the FY 1999-00 financial report in the Fall of 2000, sanitation fees will then be reviewed to determine if a fee adjustment is required. Our last fee adjustment of 3% was implemented in March 1998.





### **Golf Fees**

Golf fees for residents will remain unchanged, while fees for non-residents changed in June 1999, increasing by \$1 per nine holes for the Summer season. Our current fees continue to compare favorably with those of surrounding communities. For the near term, this fund is projecting sufficient revenues to meet expenditures. Rate reviews will continue annually.

### **Other Considerations**

We will continue to closely monitor the distribution methodology of State-Shared Revenues. Recent cuts in the state vehicle license tax held cities and towns harmless from any loss. However, a hold harmless clause attached to this year's income tax cut was not successful, translating to a statewide \$20 million cut in income tax sharing in FY 2000-01. The fiscal impact to Tempe approximates \$700,000 less in state income tax revenue for FY 2000-01.

We will continue to review charges for fees for services on an ongoing basis and will bring them to Council, as necessary.

### **Financial Assessment**

Tempe continues to be financially strong. Over the years, through sound fiscal management, Tempe has positioned itself well to weather economic downturns, create a positive atmosphere for economic development, and provide greater flexibility on budgetary issues.

### **Fund Balances**

One measure of a city's financial strength is the level of its fund balances (i.e., revenues exceed expenditures). The City's estimated unrestricted fund balance in the General Fund will amount to approximately \$34.7 million as of June 30, 1999. This balance represents 29% of FY 1998-99 total General Fund revenue. Our recommended guideline for General Fund fund balance coverage is a minimum of 25% of General Fund revenues. The City's Enterprise funds (Water/Wastewater, Golf, and Sanitation programs) will have a

combined fund balance of approximately \$47.5 million at the end of FY 1998-99.

### **Financial Reserves**

Another indicator of a city's financial strength is the level of its financial reserves. Over the years the City has established financial reserves to absorb unforeseen liabilities. The City currently has self-insurance reserves totaling \$9.4 million, monies that will protect the City against potential claims. Additionally, the City has \$6.2 million in debt service reserves at June 30, 1999, monies that will help stabilize and fund future debt service obligations. Included in each of the biennial budget years and financed from current revenues are \$4.4 million of contingency funding for unanticipated emergencies. Finally, the City has established a "rainy day reserve" of \$8.0 million.

### **Bond Ratings**

The City's bond ratings are further evidence of its financial strength. Tempe's general obligation bonds are currently rated Aa1 by Moody's and AA+ by Standard & Poor's. Such rankings mean the City's bonds are considered to be of excellent investment quality, meaning lower interest rates on bonds with corresponding lower interest payments. Having solid financial policies and strong financial reserves are principle reasons for these excellent bond ratings.

### **Development Activity**

The Elliot Road corridor continues to prosper. We have seen several new major retail establishments and restaurants open in this location, further enhancing the City retail and sales activity there. In

**Moody's**

**Aa1**

**Standard & Poor's**

**AA +**

fact, the Elliot Road corridor generated \$11.5 million of local sales tax revenue for the City in FY

1998-99.

Another prosperous development within the Elliot Road corridor is the Autoplex. With a planned capacity of 21 auto dealerships, plus other ancillary businesses, the Autoplex represents a significant part of the City's financial future, given the sizable sales tax and property tax base each dealership brings to the community. We currently have nine auto dealerships with fifteen vehicle lines operating in the Autoplex.

Tempe continues to attract new companies and new development. Last fiscal year, an estimated 6,000 jobs were created in the city by companies moving into or reinvesting in Tempe. Job growth was distributed among several areas of Tempe including the ASU Research Park on the East side, the Fountainhead Corporate Park in northwest Tempe, several developments in South Tempe along the I-10 corridor, and in Downtown Tempe. Downtown Tempe also saw the opening of a 225,000 square foot corporate headquarters building for America West Airlines.

The largest economic development project in Tempe, and in the State of Arizona, is the construction of the Tempe Town Lake on the Rio Salado. Construction on the \$45 million, two-mile long lake continued throughout the year and included establishing a water recovery system to recycle the lake water, building concrete walls around the lake, and installing inflatable dams that will contain the water. In May 1999, the lake fill began. The lake fill was completed in July 1999, with the grand opening to the public scheduled for November 6, 1999. Planned development at Tempe Town Lake includes condominiums, retail, entertainment venues, hotels, and office space – offering sites for regional and national corporate headquarters. In an encouraging sign of potential development, developers of the 1000 room Peabody Hotel recently received preliminary financing commitments, with final word expected within the next six months.

While industrial development activity continues to be strong, the most significant development in

Tempe real estate this year is the emergence of a large and geographically diverse Class A office space market. As of June 1999, Tempe had over 900,000 square feet of Class A office product available or planned for the East side near the 101 freeway in South Tempe, in northwest Tempe, and in Downtown Tempe/Rio Salado.

Overall, 1998 building permit valuation totaled more than \$377 million. This number includes nearly \$300 million worth of investment in commercial, industrial, and office developments, almost exactly the same as 1997. The vacancy rate for the industrial market was 10.53% and the office market vacancy rate was 8.03% in June 1999. Residential construction, valued at over \$68

### **Favorable Development Activity**

- **Commercial Development**
- **Industrial/Office Space Absorption**
- **Job Growth**

million, was down from 1997 because of Tempe's scarce supply of undeveloped land. The remainder of the \$377 million was invested by schools, government, and churches.

Residential development is slowing due to the limited area remaining for residential growth. Conversely, commercial activity has risen, reflecting impressive dividends both from our own economic development initiatives and programs, and the favorable economic climate in the metro Phoenix area. In the past three years, total permit activity and valuation figures approached levels we have not seen since fiscal years 1985 and 1986. That growth is expected to level off over the next year.

The projection is for continued fiscal strength and economic development success. Notwithstanding this favorable economic outlook, we remain



mindful of the cyclical nature of the economy.

## Major Policy Considerations

Budget appropriation choices were made within the context of the City's debt management plan, long-range financial capacity and strategic issues plan.

### Debt Management Plan

The favorable bond ratings are due not only to having solid fund balances and reserves, but also result from adoption of and adherence to the debt

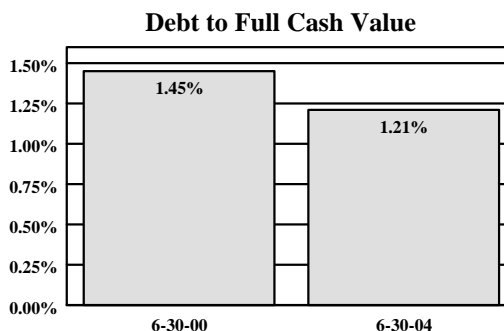
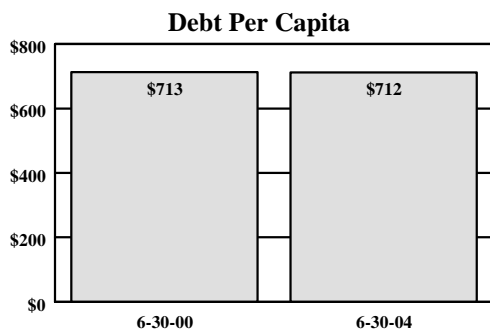
management plan by the City Council in 1989, which links our future debt capacity to population, tax base growth, and current level of general operating revenue. We update this plan annually based on these factors. For Fiscal Years 1999-01, we plan to issue \$10 million (FY 1999-00) and \$8 million (FY 2000-01) of tax-supported debt, including \$8 million (FY 1999-00) and \$8 million (FY 2000-01) of general obligation bonds and \$2 million (FY 1999-00) of transportation bonds.

Over the next five-year capital program, we plan to issue \$42 million of tax-supported bonds, all in accordance with our debt management plan.

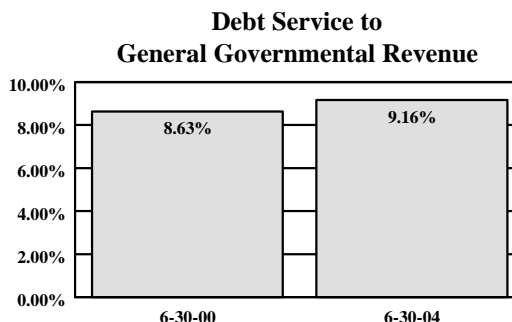
### Long-Range Financial Capacity

City staff prepares and updates our long-range financial plans and forecasts annually in preparation for developing suggested budget policies for Council consideration.

The long-range forecast is for continued financial strength through the next five years. A "Long-Range Forecast" Section is included in the Biennial Budget which describes revenues and expenditures, issues, trends, and resource choices for all funds.



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| <b>Debt Management Plan Benchmarks:</b>        |
| Outstanding Debt Per Capita: \$450-\$500       |
| Outstanding Debt to Full Cash Value: 1.1-1.25% |
| Debt Service to Operating Revenue: 14-16%      |



## Council Budget Policies for FY 1999-2001

The operating budget embraces the following tenets that over the years have made the City financially strong:

- the budget *provides that current revenues are sufficient to support current expenditures* (“We are living within our means” without drawing down general fund reserves for operating purposes); the budget maintains the City’s strong general fund reserves;
- the budget *provides for a General Fund contingency appropriation* sufficient to support emergencies and unforeseen circumstances, given past experience in the City;
- the budget *provides sufficient levels of maintenance and replacement dollars* to ensure that all capital facilities and equipment are properly maintained;
- the budget *requires no increase in the total property tax rate*. The tax rate for FY 1999-00 is \$1.40 per \$100 assessed valuation; Also, the Council recently declared its intent to lower the property tax rate to \$1.35 per \$100 of assessed valuation in FY 2000-01;
- the budget *maintains a competitive compensation and enhanced benefits* package, which is one of the finest anywhere.

With these basic tenets as a guide, combined with the direction provided by our long-range financial planning process, the following budget policy direction was followed for FY 1999-01:

**1. Over the next five years, General Fund revenues will increase at a rate slower than projected expenditures. Equalizing the growth rate of both revenues and expenditures is essential to avoid future expenditure cuts or tax increases.**

- Limit recurring supplemental operating expense additions to \$1.0 million and non-recurring supplementals to \$1.5 million within the General Fund (The long-term policy is to limit recurring General Fund supplementals to \$500,000 annually. For

the biennial budget, the Council approved a \$1.0 million recurring limit to fund needs in public safety and other programs having a high priority with the Council and Tempe residents);

- Minimize midyear adjustments;
- Limit operating budget impacts to the Capital Improvements Program to \$750,000 annually for the biennial budget period of 1999-01;
- Provide \$302,172 in Year 1 and an additional \$218,000 in Year 2 for enhanced employee benefits.

**2. Based upon the Long-Range Financial Capacity Study, allocate anticipated surplus from the General Fund for non-recurring expenses as follows:**

- Allocate 1/3 to the Rio Salado program for capital improvements;
- Establish reserves, with the balance of surplus revenue going to the Capital Improvements Program as pay-as-you-go financing.

**3. The economy continues to signal a slowdown. Maintain the City’s strong financial reserve program.**

- Cap the Rainy Day Reserve at \$8 million;
- Increase the Rio Salado Reserve to \$10 million by increasing the current \$7.5 million reserve by \$1.25 million in each of the two years of the biennial budget;
- Keep the General Fund fund balance at a minimum of 25% of General Fund revenues.

**4. Although the past ten years have shown an average annual increase in assessed values of 2.16%, we are projecting the next 10 years average at 3.5%. This increased assessed value provides increased bond capacity.**

- Increase the Debt Management Plan’s G.O. Bond funding for tax supported debt to \$8.0 million annually beginning in FY 1999-00. No increase in the property tax rate (\$1.40/\$100 of assessed value) is needed to

fund the increased capacity. As indicated above, the City intends to lower the property tax rate in FY 2000-01.

**5. The City's revenue structure must be examined regularly to insure minor inflationary pressures do not go unnoticed requiring large percentage increases at some time in the future.**

- Continue annual evaluations of enterprise funds (water, sewer, refuse and golf) with the purpose of recommending smaller percentage increases at routine intervals as opposed to waiting a longer period of time and requiring substantially larger percentage increases;
- Place fees for services on a regular review schedule as follows:
  - Year 1: Development related fees (building permits, plan check, etc.);
  - Year 2: Community Services fees (recreational, social services, library);
  - Year 3: Criminal Justice system fees.

**6. As the City moves forward with the Biennial Budget process, the following policy guidelines are being implemented to provide flexibility over the 24-month budget cycle.**

- Implement a modified gainsharing approach whereby unspent budgeted dollars in supplies/services/capital outlay will carry over into the second year;
- Carry over salary savings with Department Head and Management Services approval

for specific purposes on a non-recurring basis;

- Minimize midyear adjustments.

**7. Institute semi-annual budget reviews with the City Council.**

**8. Continue examination of current programs by each Department for potential "sunsetting" or budget trade-off.**

**Strategic Issues**

The City formed six strategic issues teams to provide more strategic focus to resource allocation choices. The 1999-01 biennial strategic issues are:

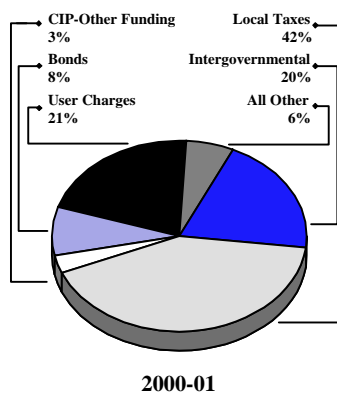
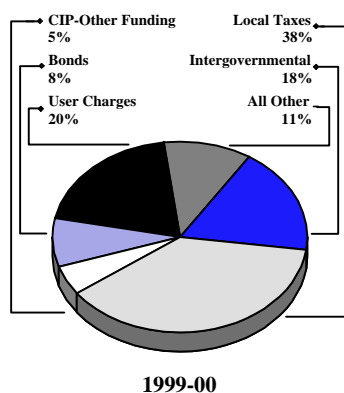
- *Community and Economic Development*
- *Finance and Human Resources*
- *Neighborhood Enhancement*
- *Public Safety*
- *Public Works and Transportation*
- *Youth, Family, and Community Services*

The task of each strategic team was to delineate long-range goals, formulate a cohesive strategy for each of the six areas, and develop action plans to advance us toward those strategic goals. Basic services were also identified as a top priority in evaluating resource allocation choices.

**Income/Outgo**

The pie charts below and on the following pages portray the City's income and outgo. Revenues are

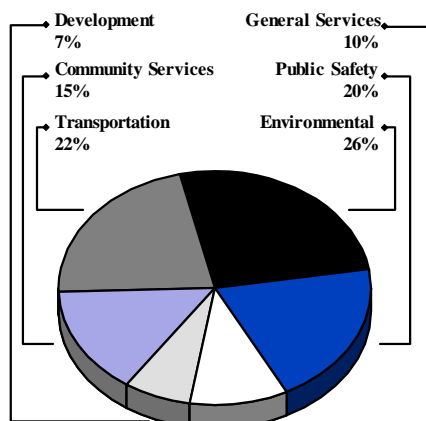
**Where the Money Comes From  
by Source of Funds**



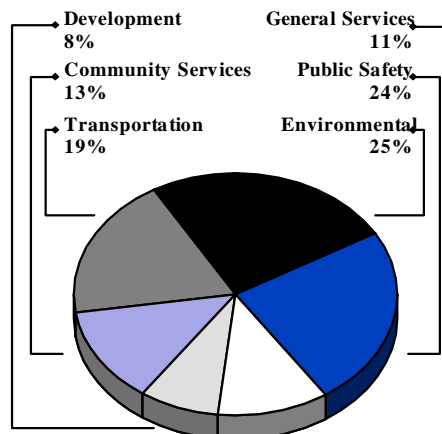
grouped by major category, while expenditures are shown by program area and by type of expenditure (such as personal services). Local taxes (e.g., city sales tax and property tax) continue to be the largest City revenue source, representing 38% of the FY 1999-00 total revenue budget, increasing to 42% in FY 2000-01. Other major revenue sources include user fees (such as water service and refuse fees) and intergovernmental revenue.

The following pie charts show a breakdown of City expenditures and where the money is spent by program. Environmental Health and Public Safety represent the greatest areas of program appropriation, accounting for 49% of the FY 2000-01 total financial program. With new funding added over the course of the biennium, Public Safety moves up to the second largest program area by FY 2000-01.

### Where the Money Goes by Type of Program



1999-00

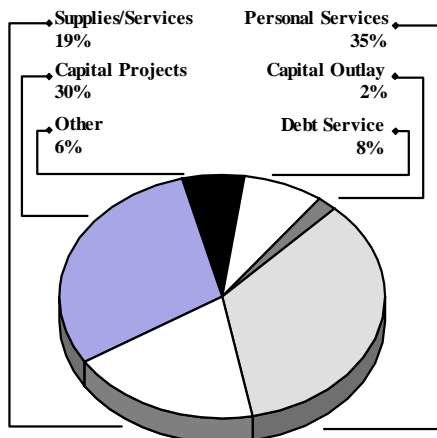


2000-01

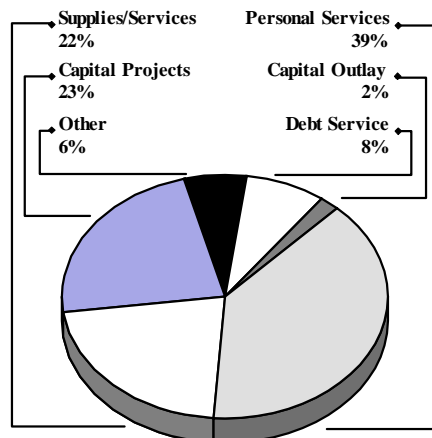
The final chart portrays budget appropriations by line-item category. As you may expect with a service-type organization, Personal Services

(salaries, wages and benefits) represent the largest portion of the total financial program.

### Where the Money Goes by Line Item Category



1999-00



2000-01

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## Conclusion

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The favorable economic activity throughout our local and regional economy provided flexibility in preparing the City's first ever biennial operating budget. Aside from improving long-range planning, the transition to a biennial budget will allow a broader policy orientation that focuses on strategic issues, program evaluation, and benchmarking the second year of the biennium.

We continue to focus on our long-range financial plan on further streamlining the City's operations and lowering costs. By adopting the long-range plan of limiting recurring General Fund operating expense additions (supplements) for fiscal years 1999-01, our projections show that we can provide for a balanced General Fund program through at least FY 2003-04 without seeking further tax adjustments for General Fund purposes in the community. This assumes no change in state revenue allocation policy, an economic downturn or major new programs over the next five years.

The adopted biennial budget reflects the Council's policy of preserving Tempe's strong financial position by maintaining strong fund balances and reserves, attracting and retaining high quality staff with highly competitive salaries and benefits, adding new programs cautiously and making decisions within the context of our long-range financial capacity study and debt management plan. The budget asserts our commitment to meet and exceed our community's high expectations. We continue to meet these needs at the lowest possible cost to our citizens.

With final budget adoption, I want to thank the Mayor and City Council, citizens and City staff for their time and effort throughout this budget process.

Respectfully submitted,

Gary Brown, City Manager